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Market Review

February 2013

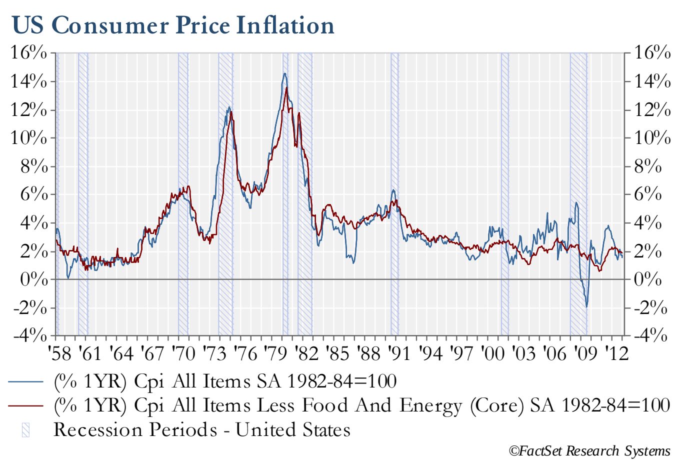
Economic Review

U.S. real GDP increased at an annual rate of +0.1% in the fourth quarter of 2012, according to the second estimate released by Bureau of Economic Analysis (BEA). The revised estimate is 0.2% higher than the previous estimate, primarily reflecting an upward revision to exports and non-residential fixed investment, along with a downward revision to imports - all of which were partly offset by the downward revision to private inventory investment. While the revised estimate changes the direction of real GDP growth, it was lower than the expected +0.5% and significantly lower than the previous quarter's +3.1%. Real GDP increased 2.2% in 2012, after increasing 1.8% in 2011.

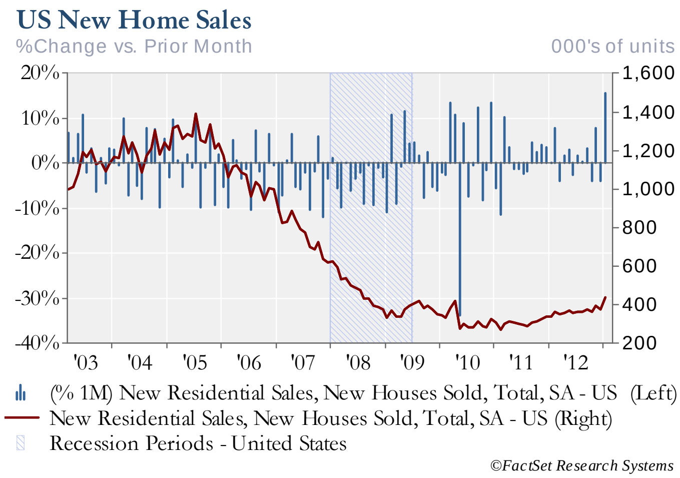
BEA Estimates of 2012 Q4 Contributions to GDP		
Category	*Advance*	*Second*
Real GDP	**-0.1**	**0.1**
Personal Consumption Expenditure	1.52	1.47
Gross Private Domestic Investment	-0.08	-0.2
Governemnt Consumption Expenditure	-1.33	-1.38
Net Exports	-0.25	0.24

Source: BEA

Inflation in the U.S. remained tame as the headline CPI did not change in January, the second consecutive month of stagnant prices, while the year-over-year CPI increased 1.6%. The monthly Core CPI (i.e., excluding Food and Energy) rose 0.3%, the largest increase since May 2011, while year-over-year Core CPI increased 1.9%. The 5 year/5 year forward breakeven inflation rate declined 5 bps (approx.) to 2.83%, indicating expectations of slightly lower inflation in the future.



The 20-city S&P Case-Shiller Index gained 0.2% in December and was up 6.8% for 2012, the best yearly growth since 2005. Sales of new homes rose 15.6% in January, the highest level since July 2008. Existing homes sales rose at a less-than-expected 0.4% to 4.92 million annualized rate (a.r.) in January. New home construction fell 8.5%, although building permits for single-family homes did increase 1.8%.



The U.S. economy added 157,000 total jobs in January, below the consensus estimate of 195,000, while the number of jobs added in both November and December were revised upward. The unemployment rate ticked up to 7.9% in January from 7.8% in December according to the U.S. Bureau of Labor Statistics (BLS) report.

The Conference Board's gauge of U.S. consumer confidence rose to 69.6 in February, up from a revised 58.4 in January, topping economists' estimates of 61. This rebound reverses three straight months of declines. The pace of growth in the services sector accelerated as the ISM Non-Manufacturing Index increased to a twelve month high of 56 in February, from 55.2 in the previous month and above the consensus of 55. The ISM Manufacturing Index also accelerated in February, recording 54.2 from 53.1 in January, and above the consensus of 52.5. The improvement in both non-manufacturing and manufacturing indices primarily reflected an increase in the respective new orders sub-component. The U.S. trade deficit shrank more than 20% to $38.5 billion, its lowest point in almost three years, due to record oil exports in December.

The minutes from the Federal Open Market Committee's January meeting revealed an ongoing debate among members as to the duration of its asset purchase program. A number of' Fed officials were concerned about how possible financial market distortions may compel the central bank to wind down its asset purchases, while others were concerned about ending the purchases too early. In a testimony to the

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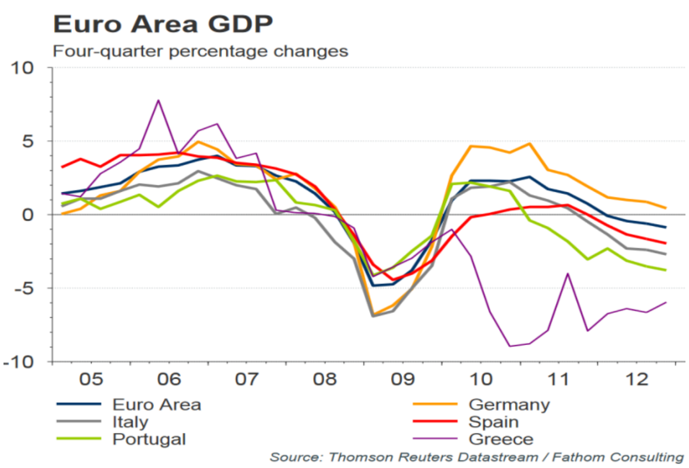
Senate Banking Committee, Fed Chairman Ben Bernanke stated that the benefits of the Quantitative Easing program outweigh the potential costs, indicating that the purchases would likely continue for some time.

The European Central Bank (ECB) and Bank of England (BoE) kept their respective policy rates on hold. The Eurozone economy contracted for a third consecutive quarter, declining 0.6% quarter-over-quarter, versus an expectation of a 0.4% drop during the fourth quarter of 2012. The Eurozone economy contracted 0.5% during 2012 after expanding 1.5% in 2011. Within the Eurozone, Germany grew by 0.9%, France was flat and Italy and Spain contracted by 2.2% and 1.4% respectively.



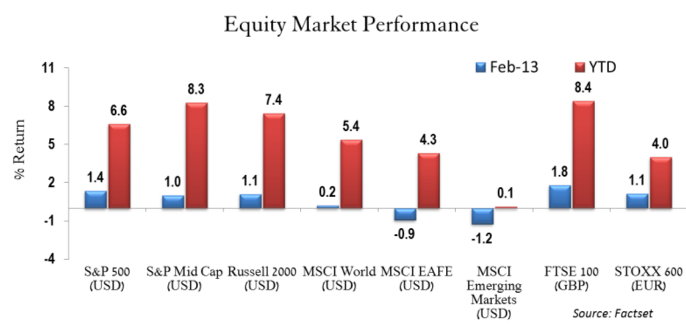
In Italy, the pro-austerity government led by Mario Monti was defeated with the elections resulting in a political stalemate, raising fears that rising anti-austerity sentiment could derail the progress made under Monti. ECB President Draghi called for inflation significantly below 2% next year and said the ECB is far from having an exit from the stimulus efforts in mind. The BoE minutes were also dovish with three members, including Governor Mervyn King, favoring additional stimulus to boost the U.K. economy. The proposal for increased stimulus was rejected by the six other voting members of the BoE. Moody's downgraded the United Kingdom's domestic and foreign government bond rating from Aaa to Aa1 with a stable outlook.

The government and HSBC manufacturing PMIs for China came in at 50.1 and 50.4 respectively, indicating stagnation in February. Indian fourth quarter real GDP grew at +4.5% year-over-year, the slowest in nearly four years. Brazilian real GDP grew at a disappointing +0.6% during the same period.

The Bank of Japan (BoJ) left its policy interest rate in the 0 to 0.1% range and did not change the size of its asset purchases. In a statement prompted in part by Japan's recent aggressive actions to devalue the Yen, the G7 stated that fiscal and monetary policies must not be directed at devaluing currencies. Japanese Finance Minister, Taro Aso, said that the steps taken by Japan were aimed towards beating deflation and not influencing currency markets. Japanese Prime Minister Shinzo Abe, nominated the dovish ADB President Kuroda to be the next Bank of Japan Governor.

Equity Markets

February was a volatile month for equities. Developed equity markets made modest gains amidst sluggish global demand, an inconclusive Italian election, the downgrade of the UK and worries over a change in Federal Reserve policy. After a sharp sell-off, likely precipitated by the Fed minutes and the Italian election, the S&P 500 rallied into the month end to close February up 1.4%; its fourth consecutive month of gains. Emerging markets had the worst month since May 2012.

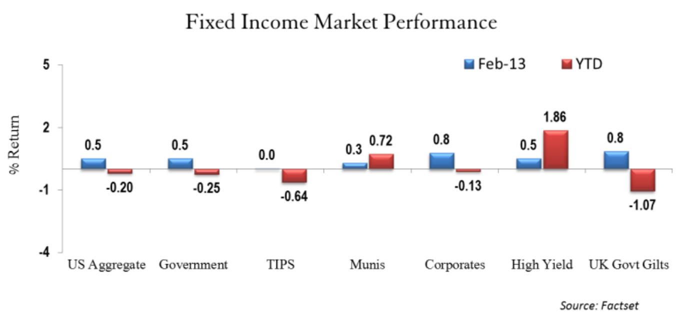


After a strong rally in January, U.S. equity markets saw some pull back in early February due to political turmoil in Spain and Italy. Investor enthusiasm over merger and acquisition activity and better U.S. economic data helped the S&P 500 extend its winning streak to seven weeks. However, signs of an early end to Fed stimulus, weak European manufacturing data and no clear winner in Italy rattled markets, causing equities to drop steeply. The tide again reversed following evidence of housing market recovery and strong earnings from discount retailers. The Dow Jones Industrial Average set a new post financial crisis high toward the end of the month and came close to its 2007 all-time highs.

Bond Markets

The Barclays U.S. Aggregate Index gained 0.5% in February, as a late month drawdown in equities pushed investors into higher quality assets. Investment Grade Corporates were the best performing fixed income class in February, rising 0.8%. Credit spreads, measured by the Bank of America Merrill Lynch U.S. High Yield Master II Option-Adjusted Spread, widened for the first time in 11 months, closing February 6 bps higher. The Barclays U.S. High Yield Index, however, gained 0.5% on the month, with most of the return attributable to a rally in treasury bonds. High yield bonds have posted a gain of 18% in the past twelve months.

The yield on the 30-year Treasury Bond fell 8 bps in February to 3.09%, and the 10-year Treasury fell 11 bps to 1.88%. The 30/2 yield curve tightened 6 bps. The 10-year Euro Bond Composite yield fell 23 bps in February, closing the month at 1.45%. UK Government Gilts gained 0.8% in February. The German 2-year Benchmark Bond declined 22 bps to close February at 0.04%, the lowest level since the yield turned positive on January 2nd of this year.

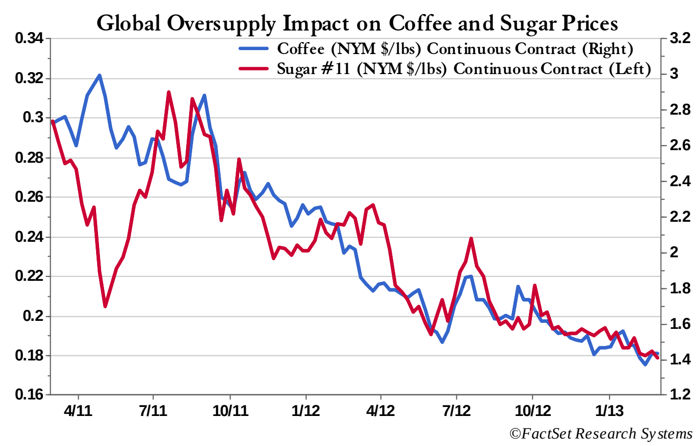


Commodities

The S&P GSCI Total Return Index declined 4.39% in February, as all sub-indices fell during the month to give back a strong January performance. Only the energy-related sub-indices remain in the black for 2013. Precious Metals and Industrial Metals were the worst performers, both losing over 5%.

Natural Gas was the strongest performing commodity in February, rising 2.4% to close the month at $3.537. Natural Gas rallied strongly from mid-month due to lower than expected inventory and storage numbers. At the end of February, total U.S. Natural Gas storage was 2.3 trillion cubic feet, over 300 billion cubic feet less than this time last year. Cotton continued its torrid start to 2013, with a 1.5% gain to bring YTD returns to over 12%.

Other than Natural Gas and Cotton, all major commodities posted losses on the month. Coffee declined 4.5% in February, bringing total losses to 28% over the last 12 months. The Coffee market is struggling due to Arabica bean oversupply concerns, despite a fungal outbreak in Central America, which growers cite as a threat to the next harvest. Sugar prices continued to fall on global oversupply concerns, as a 2.2% loss in February brought the future's continuous 12-month decline to over 25%. Attempts to divert sugar crops into energy production by the Brazilian government have thus far failed to stop the decline in prices. Gold (down 5%) and Silver (down 9.5%) continued to struggle as equity markets stabilized and short-term inflation concerns dwindle.



Currency

The US Dollar had a very strong month in February, advancing against most major currencies and dampening inflation fears. The US Dollar Index, which tracks the currency against those of six major U.S. trading partners, advanced 3.37% in February. The British Pound declined 4.26% against the US Dollar, as expectations for additional stimulus and currency weakening from the Bank of England grew. The Euro declined 3.69% against the USD this month, as France, Spain, and Italy dragged the Eurozone deeper into recession. The Japanese Yen depreciated 1.08%, closing at ¥92.26/USD. The Yen has depreciated over 13% against the US Dollar over the last 12 months as the Bank of Japan continues to push unlimited stimulus and purposeful currency devaluation.